D.T.E. 02-19

Petition of Berkshire Gas Company for approval by the Department of Telecommunications and Energy of a Portfolio Agreement and Gas Sales Purchase Agreement entered into between Berkshire Gas Company and BP Energy Company.

APPEARANCES: James M. Avery, Esq.
Brown, Rudnick, Berlack, Israel, LLP
One Financial Center
Boston, Massachusetts 02111
FOR: Berkshire Gas Company
Petitioner

Thomas Reilly, Attorney General
By: Alexander Cochis
Karlen J. Reed
Assistant Attorneys General
200 Portland Street
Boston, Massachusetts 02114
FOR: Office of Attorney General
Intervenor

Matthew T. Morais, Esq.
Commonwealth of Massachusetts Division of Energy Resources
70 Franklin Street
Boston, Massachusetts 02114
FOR: Department of Energy Resources
Limited Participant

Patricia Crowe, Esq.
KeySpan Energy Delievery New England
One Beacon Street
Boston, Massachusetts 02108
FOR: Boston Gas Company
Limited Partcipant

I. INTRODUCTION

On April 5, 2002, Berkshire Gas Company ("Berkshire" or "Company"), pursuant to G.L. c. 164, §§ 76[1] and 94A, submitted for approval by the Department of Telecommunications and Energy ("Department") a Gas Portfolio Optimization Agreement ("Optimization Agreement") and a Gas Sales and Purchase Agreement ("Purchase Agreement" or collectively "Agreements") that the Company executed with BP Energy Company ("BP").[2] The Optimization and Purchase Agreements were negotiated and executed pursuant to the Department's prior order concerning Berkshire's Request for Proposals ("RFP") process approved in Berkshire Gas Company, D.T.E. 01-41 (2001) ("D.T.E. 01-41").[3] The Department approved similar agreements in D.T.E. 01-41. Pursuant to G.L. c. 25, § 5D, Berkshire also submitted with the filing a Motion for Confidential Treatment of specific terms and conditions contained in the Optimization and Purchase Agreements. The Company's proposal has been docketed as D.T.E. 02-19.

On May 24, 2002, pursuant to notice duly issued, the Department conducted a public hearing to afford interested persons the opportunity to comment on the Company's proposal. The Attorney General of the Commonwealth ("Attorney General") intervened as of right,

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1 G.L. c. 164, § 76 provides the Department with supervisory authority over all gas companies to ensure the companies' compliance with laws in the Commonwealth and all Department orders, directives, and requirements.

2 BP is a subsidiary of Amoco Production Company and an indirect wholly-owned subsidiary of BP Corporation North America, Inc. BP operates as a natural gas marketer and trader of natural gas (Exh. AG 1-15).

3 The Department approved the Optimization Agreement and Purchase Agreement in D.T.E. 01-41.

pursuant to G.L. c. 12, § 11E. The Department granted the Petition to Intervene of the Division of Energy Resources ("DOER") and granted limited participation to KeySpan Energy Delivery New England.[4]

On June 24 and July 8, 2002, the Department held evidentiary hearings on the Company's proposal. The Company presented the testimony of Karen Zink, Berkshire's vice-president of marketing and resource planning, Kevin Bass, the trading manager for the East region of BP, John Hormell, a storage manager for the Energy East Alliance, and Thomas W. Deering, an audit supervisor with New York State Electric and Gas Corporation. On July 24, 2002, the parties submitted briefs. On August 13, 2002, the Company submitted a reply brief.

II. DESCRIPTION OF THE PROPOSED AGREEMENTS

A. Optimization Agreement

The Optimization Agreement is the product of a coordinated effort by Berkshire and three other natural gas local distribution companies that are subsidiary operating companies of Energy East Corporation – Connecticut Natural Gas Corporation, New York State Electric & Gas Corporation and The Southern Connecticut Gas Company (collectively, "LDCs" or, with Berkshire, "members of the Alliance") (Exh. BG-1, at 2). The Optimization Agreement is designed to provide a mechanism by which Berkshire and BP will use the Company's gas portfolio to transport, store, purchase, and sell gas in an attempt to reduce the costs of gas to

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[4] On June 21, 2002, DOER informed the Department that it was withdrawing as a full party in this proceeding and becoming a limited participant.

the Company's customers as a result of the transactions (Exh. BG-1, § 2.1).[5] Pursuant to the Optimization Agreement, BP would serve as Berkshire's agent, and would schedule receipts and deliveries of gas into, and revise nominations from, Berkshire's existing portfolio (id. § 2.4). Under the Optimization Agreement, the commodity costs of gas would be determined by the least-cost routing of the gas and would rely upon production area indices, pre-existing contract prices, and actual pipeline variable costs (id. § 12.1).

According to the Optimization Agreement, the portion of gas costs savings that Berkshire would realize as a result of the alliance with BP would be determined by a formula (id. § 4.2). Similarly, the Optimization Agreement provides that BP would be compensated based only on the incremental savings above individual benchmarks that Berkshire and the other LDCs realize from BP's efforts (id. § 4.3).[6]

Berkshire stated that the Optimization Agreement extends and modifies the terms of the "Alliance" structure pursuant to which Berkshire will continue to pursue a variety of

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5 The Company filed a Motion for Protective Treatment of Confidential Information ("Motion") concerning certain pricing and pricing-related information contained in the filing. At the public hearing, the Hearing Officer granted the motion subject to approval of a list of all the information for which the Company was seeking protective treatment. The Company submitted that list at the evidentiary hearing (Exh. BG-13). Also at the evidentiary hearing, the Company moved to seal the entire transcript and to have a redacted version of the transcript available for the public record (Tr. 1, at 61-62). Upon examination the Department finds that the designated material is appropriate for confidential treatment for the term of the Agreements.

6 The Company executed several ancillary agreements in connection with the Alliance documents, including an allocation agreement, that memorialized the procedures to be employed in terms of the allocation of savings generated within the Alliance among the Company and the LDCs (see Exh. BG-1, exh. B-10). The Company also executed a netting agreement that memorializes certain payment or settlement procedures (id., exh. B-9). These ancillary agreements were included with the Optimization Agreement.

opportunities to secure gas cost savings for the benefit of its customers (Exh. BG-7, at 9). The structure of the previously approved Optimization Agreement is preserved in the current Optimization Agreement. Specifically, (1) Berkshire will continue to control and manage its existing and approved gas supply, transportation and storage resources, seeking to build upon its resources to generate gas cost savings for the benefit of its customers; (2) Berkshire will continue work with its affiliated LDCs to generate savings that have been made available by mergers involving the Energy East Corporation; and (3) Berkshire and the LDCs will continue to work with BP to pursue additional value through transactions that may be generated or identified by BP or through the application of BP expertise and resources (Exh. BG-7, at 9).

The Company stated that under the Optimization Agreement, the transactions will be overseen by a six member "Alliance team" made up of representatives from the different Alliance companies (RR-DTE-3). BP and the Company will continue to work together on a daily basis to further reduce commodity costs associated with delivery of gas volumes, storage fill, and transportation, while maintaining the level of reliability (See e.g. Exh. BG-1, Art. II; Exh. AG 1-13; Exh. AG 1-19; Tr. 1, at 98-99).

Berkshire stated that as part of the consideration of the renewal or extension of the Alliance, the Company and the LDCs commissioned a comprehensive audit of Alliance procedures and controls. An experienced internal audit team was organized (Tr. 2, at 177-78).[7] The Company explained that detailed field work, interviews, and validation activities

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7 The Company argued that the decision to apply internal auditors to this task was reasonable and appropriate. The Company submits that the detailed audit workpapers demonstrate the diligence of the audit (See RR-AG-8). In addition, Energy East's

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were performed (Tr. 2, at 179-84). While many potential audit techniques could have been employed, the audit of the members of the Alliance involved a comprehensive evaluation of all aspects of the members of the Alliance activity for a particular month, September 2001. According to Berkshire, this election enabled the auditors to examine and review activities and transactions at a greater degree or depth (Tr. 1, at 189-190).

The Optimization Agreement is for a two-year term through and including March 31, 2004, unless either party terminates the contract for any of the specified reasons provided for in the Optimization Agreement (Exh. BG-1, § 3.2).

B. Purchase Agreement

The proposed Purchase Agreement operates in conjunction with the terms and conditions of the Optimization Agreement (Exh. BG-4). Under the Purchase Agreement, BP would provide Berkshire with the Company's Gulf Coast production area gas requirements and such other quantities of gas upon which BP and Berkshire may mutually agree (Exh. BG-4, Art. IV). Concerning the quantities of gas the Company can buy from BP, the Purchase Agreement references a section of the Optimization Agreement that states that the Company must satisfy the Company's purchase obligations under the Company's supply agreements in the Company's gas portfolio before purchasing gas from BP (Exh. BG-4, Art. IV; Exh. BG-1, § 2.7; Exh. BG-1, exh. B-1). Pricing under the Purchase Agreement is based on market indices and a supply reservation charge (Exh. BG-4, Art. V).

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[7](…continued)
external auditors are likely to review the audit report (Tr 2, at. 207). As a consequence, the Company will benefit from a second level of audit activity.

III. STANDARD OF REVIEW

In evaluating a gas utility's options for the acquisition of commodity resources as well as for the acquisition of capacity, pursuant to G.L. c. 164 § 94A, the Department examines whether the acquisition of the resource is consistent with the public interest. Commonwealth Gas Company, D.P.U. 94-174-A at 27 (1996). To determine whether the proposed acquisition of a resource is consistent with the public interest, the Department evaluates whether, at the time of the acquisition or contract renegotiation, the transaction (1) was consistent with the company's portfolio objectives and (2) compared favorably to the range of alternatives reasonably available to the company and its customers, including releasing capacity to customers migrating to transportation. Id.

As part of the review of relevant price and non-price attributes, the Department considers whether the pricing terms are competitive with those for the broad range of capacity, storage, and commodity options that were available to the LDC at the time of the acquisition, as well as with those opportunities that were available to other LDCs in the region. Id. In addition, the Department determines whether the acquisition satisfies the LDC's non-price objectives including, but not limited to, flexibility of nominations and reliability and diversity of supplies. Id. at 29.

The Department has established that an RFP process will be deemed acceptable if the process was "fair, open and transparent." NOI - Gas Unbundling, D.T.E. 98-32-B at 54-55 (1999).

IV. DISCUSSION

A. The RFP Process

1. Description of the Berkshire RFP and Joint RFP

The Company stated that it issued two RFPs; the first RFP involved the supply portfolio of Berkshire only, while the second RFP combined the portfolios of all the members of the Alliance (Exh. BG-7, at 7-8). On November 14 and 15, 2001, Berkshire issued a "Request for Proposal for Portfolio Services ("Berkshire RFP") to eight companies for portfolio services (Exh. AG 1-15).[8] Four of the eight companies responded to the Berkshire RFP (Exh. D.T.E. 1-2).[9] According to the Company, the Berkshire RFP had the following objectives: (1) to provide reliable and least-cost gas supply and transportation service to Berkshire's customers; (2) to take advantage of the competitive elements of the natural gas market by optimizing the value of Berkshire's supply, transportation, and underground storage assets; and (3) to substantially reduce the Company's unit cost of gas at Berkshire's city gates, through optimization of the Company's resource portfolio (Exh. AG 1-15). The Company explained that it rejected all the proposals submitted in response to the Berkshire RFP because "the Company did not believe that it was appropriate to accept proposals that provided significantly less than the optimizing dollars that had been achieved previously" (Exh. D.T.E. 1-2).

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8 Berkshire sent RFPs to the following companies: Coral Energy Resources, LP; Duke Energy Trading & Marketing, LLC; Dynegy Marketing and Trade; El Paso Merchant Energy; Energy USA-TPC Corporation; Mirant Americas Energy Marketing, LP; PG&E Energy Trading Corp.; and Sempra Energy Trading Corp (Exh. D.T.E. 1-3).

9 The companies that responded were: Duke Energy Trading and Marketing, LLC, Dynegy Marketing and Trade, El Paso Merchant Energy, and Energy USA-TPC Corporation (Exh. D.T.E. 1-3).

The Company stated that it subsequently joined the members of the Alliance to solicit bids ("Joint RFP") on December 21, 2001, from eleven companies for portfolio services (Exh. D.T.E. 1-3; Exh. D.T.E. 1-4; Exh. AG 1-15).[10] Nine companies responded to the Joint RFP (Exh. D.T.E. 1-3; Exh. D.T.E. 1-4).[11] According to the Company, the Joint RFP had the following objectives: (1) to provide expected reduction in the cost of gas for the members of the Alliance; (2) to allow the ability to capitalize on the benefits from a larger gas portfolio made available through the members of the Alliance mergers and pending merger; (3) to experience no decline in reliability of service; (4) to complement or supplement existing in-house expertise of the Companies; (5) to increase the existing skill-set and in-house capabilities of the members of the Alliance; (6) to assist in price risk management/price stability; (7) to allow exposure to broader markets; and (8) to allow for the companies' retention of control over their individual assets/portfolios (Exh. AG 1-15).

Berkshire stated that the members of the Alliance selected BP as the winning bid based on both price and non-price factors (Exh. AG 1-15,; Exh. D.T.E. 1-4). These factors included: (1) the extent to which qualified respondents could demonstrate the capability to

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10 The Alliance solicited bids from the following companies: AEP Energy Services, Inc., Amerade Hess Corporation; Aquila Energy; BP Energy Company; Duke Energy Trading and Marketing, LLC; Dynegy Marketing and Trade; El Paso Merchant Energy; Energy USA-TPC Corporation; Mirant Americas Energy Marketing, LP; PG&E Energy Trading Corp.; and Sempra Energy Trading Corp.

11 The Alliance received bids from the following companies: AEP Energy Services, Inc.; BP Energy Company; Duke Energy Trading and Marketing, LLC; Dynegy Marketing and Trade; El Paso Merchant Energy; Energy USA-TPC Corporation; Mirant Americas Energy Marketing, LP; PG&E Energy Trading Corp.; and Sempra Energy Trading Corp.

perform the required services; (2) the availability of reliable supplies necessary to meet the supply requirements of the members of the Alliance; (3) the organizational experience of the respondent in portfolio services, achievement of savings, and back office capability; (4) the financial strength of the respondent and its guarantor, if any, and the ability to provide satisfactory credit support; (5) the ability to manage financial and physical risk; and (6) the level of savings to be realized by the members of the Alliance and their customers (Exh. AG 1-15, Att.; Exh. D.T.E. 1-4).

2. Positions of the Parties

a. Attorney General

The Attorney General did not submit any objection to the Berkshire RFP process or the Joint RFP process regarding its fairness, openness, or transparency.

b. Berkshire

The Company argues that it complied with the Department's directive in D.T.E. 01-41 to issue a new RFP prior to renewing the 2001 Optimization and Purchase Agreements with BP for a consecutive term by issuing a Company-specific RFP in November 2001 (Exh. BG-7, at 7; Exh. AG 1-15; Tr. 1, at 15; Tr. 2, at 359-360, 365-366). The Company explains that the responses to its stand-alone RFP were limited and disappointing, reflecting "not only the changed market conditions but also the more limited value of the Company's resources on a 'stand-alone' basis" (Exh. BG-7, at 8; Exh. D.T.E. 1-2; Tr. 2, at 368-369). The Company states that because of its failure to obtain a satisfactory response to its bid and "[i]n order to attempt to secure the best opportunity for optimization or capacity management and consistent with the Department's findings on the merits of regular market solicitations, the Company elected to participate in a joint solicitation with the LDCs" (Exh. BG-7, at 8). The Company argues that the competitive bidding process that it conducted with the other LDCs was fair, open, and transparent and complied with Department precedent (Exh. BG-7, at 7-8; citing Berkshire Gas Company, D.T.E. 01-41, at 10-11; Berkshire Gas Company, D.T.E. 99-81, at 3-5; Boston Gas Company, D.T.E. 99-76, at 20-22).

3. Analysis and Findings

In Berkshire Gas Company, D.T.E. 01-41, at 14 (2001), the Department approved Berkshire's RFP process, which led to the execution of the 2001 Optimization and Purchase Agreements between the Company and BP. The Department found, in that proceeding, that the RFP process was appropriately conducted and that the process was fair, open, and transparent. Id. at 11. The Department directed Berkshire to issue a new RFP prior to renewing the 2001 Optimization and Purchase Agreements with BP for a consecutive term, and "to demonstrate to the Department that renewing the Optimization and Purchase Agreements would likely produce benefits to Berkshire that would equal or exceed other market offerings." Id. at 13-14.

The Department notes that the bid solicitation and evaluation process followed by the Company and the LDCs in this proceeding was similar to the process approved in D.T.E. 01-41.[12] In determining whether the Berkshire RFP and the Joint RFP processes were fair, open, and transparent, the Department notes that potential bidders were notified on the specifics of

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[12] The Department notes that Berkshire did not solicit a bid from BP for the Company-specific RFP because Berkshire did not want BP to have to negotiate against itself (Tr. 2, at 368). The Department accepts the Company's explanation.

how each bid would be evaluated. Specifically, in both the Berkshire RFP and Joint RFP, the evaluation process was clearly stated to each potential bidder, evaluation criteria were provided, and there was an opportunity for bidders to request clarification from the Company on both the evaluation criteria and the RFP process itself. In addition, the bids were evaluated and the winning bid selected based on the criteria set forth in the RFPs. Thus, the Department finds that the RFP processes were fair, open, and transparent.

The Department notes that it has received no objections from potential bidders from either RFP to indicate that a bidder was unfairly excluded from initial consideration or that a bid was unfairly evaluated. Accordingly, the Department finds that the Berkshire RFP and Joint RFP processes conducted were open, fair, and transparent. Having found that both RFP processes were conducted in a fair, open, and transparent manner, the Department approves the RFP processes as appropriately conducted.

B. Review of the Optimization Agreement

1. Positions of the Parties

a. Attorney General

The Attorney General opposes the Optimization Agreement as neither prudent nor in the public interest and states that the Department should reject the proposed agreement (Attorney General Brief at 1). The Attorney General argues that the Company speculated when it accepted the BP bid over other bidders who offered a management contract with a fixed payment (id. at 2). According to the Attorney General, this speculation hurts the Company's customers because the Company speculated with the customers' money, and the Company loses money under the proposed agreements (id. at 3). The Attorney General further argues that even if the Company receives the minimum savings, it still loses money since the Company can only receive 25 percent of the savings (id.). The Attorney General argues that the Company's belief that it can receive more of a benefit from the BP bid than from other bids is flawed because the belief ignores the risk involved in pursuit of an elusive goal (id.). Furthermore, the Attorney General maintains that under the Optimization Agreement, Berkshire has every incentive not to engage in least-cost planning by entering into contracts at higher costs that will artificially inflate savings calculations under the Optimization Agreement (id. at 4). The Attorney General argues that the Department should not permit such gaming (id.).

With respect to the audit conducted by the Company, the Attorney General asserts that the Company cannot rely on the audit as proof that the Optimization Agreement is transparent because of numerous problems with the audit (id. at 5-7). The Attorney General argues that the Company should have had an independent external audit instead of an internal audit (id.). The Attorney General argues that the Company cannot contend that time was of the essence concerning the audit since the Company was aware of the need to have an audit performed (id.). According to the Attorney General, the audit lacked sufficient scope to be meaningful because the Company's auditors did not determine whether the agreement achieved maximum savings; nor did the auditors determine whether Berkshire customers were better off as a member of the Alliance (id. at 6). Furthermore, the Attorney General argues that the Company's audit plan lacks the appropriate structure since the plan called for reviewing only a small number of transactions in the month of September (id.). Concluding its argument against the audit, the Attorney General argues that the findings of the audit are inconclusive because the allocations were still subject to further review and the reallocations could be significant (id.

6-7).

The Attorney General contends that an independent audit would indicate: (1) the actual level of benefits Berkshire customers are entitled to; (2) whether savings under the Optimization Agreement resulted in lower costs to customers relative to what costs would have been without the agreement and relative to a capacity management arrangement; and (3) whether BP unduly benefitted from the Optimization Agreement (id. at 7-8).

Lastly, the Attorney General argues that if the Department approves the filing, the approval should only be for one year not two (id. at 5). The Attorney General contends that due to the lack of evidence that Berkshire will benefit from increased savings under this agreement and the lack of a review or renegotiation provision in the contract, the Department should not allow the Company to enter into a two-year agreement (id.). During the one-year approval, the Attorney General argues that the Company should issue another RFP to test the market in order to assure that the Company is receiving the full benefit of any changes in the market and new services (id.).

b. Berkshire

Berkshire asserts that the Attorney General's arguments miss the point (Company Reply Brief at 6). Berkshire argues that its goal is not, nor should it be, simply to seek to lock in a guaranteed optimization savings amount (id.). Berkshire believes the appropriate goal is to implement an overall least-cost resource plan (id.). The Company contends that it demonstrated how the members of the Alliance contribute to such a plan (id.). Specifically, the Company contends that in a year such as 2001/2002 where costs are low and stable and weather mild, it is probable that "optimization" results may be in the lower range (id.). The Company asserts that its customers will benefit substantially from these low, stable prices given the approved supply contracts maintained by the Company (id.). Alternatively, the Company maintains that when prices are high and volatile, optimization opportunities are more substantial and savings would likely be in the higher range (id.). Berkshire asserts that the Agreements are appropriately structured so that savings opportunities for the Company are not capped, for the reason that, in these conditions, optimization results will play a more important role in securing a least-cost plan (id.). Finally, Berkshire asserts that the Agreements are structured with a higher guaranteed minimum payment so, even under the most unfavorable optimization conditions, the Company's customers are likely to benefit (Company Brief at 19-20).

Berkshire asserts that the Company will retain control over its resources and remains committed to satisfying its mandate to provide reliable, least-cost service (id. at 14-15). Berkshire maintains that it will continue to participate in daily discussions with members of the Alliance team members and continue to dispatch its resources based upon the best available information and internal planning (id. at 15). These team members will oversee daily transactions and monthly reports with the goal of optimizing savings through the utilization of the combined portfolios of the members of the Alliance (id.). Berkshire contends that it has substantiated this process through a detailed internal audit which confirmed that the Alliance's procedures and controls were "reasonable and are functioning as intended" (Exh. DTE 1-8, Supp. at 3; RR-AG-8).

Regarding the Attorney General's suggestion that any approval of the Agreements be conditioned upon the requirement of an independent audit, the Company argues that such an approach is unnecessary given the quality and completeness of the audit performed in this proceeding (Company Reply Brief at 20). The Company contends that an external audit is likely to be less effective because external auditors are not likely to be as familiar with gas procurement and only a single layer of review will be secured, i.e., only the review of the external auditor (id.). The Company maintains that its approach secures two layers of review – first the internal auditors and then the second level of review provided by the external auditors (id.).

As for the Attorney General's suggestion that the Department should only approve the Agreements for one year, the Company contends that this demonstrates the Attorney General's confusion concerning the Agreements (id. at 17). The Company argues that the Agreements are for a term of two years and adoption of the Attorney General's recommendation would be equivalent to a rejection of the Company's petition (id.). The Company asserts that given Berkshire's relatively small size, a specific provision was made that if the Company failed to secure Department approval, BP would be free to go forward with the LDCs (id.). Berkshire argues that it then would be left without any asset optimization assistance (id.). The Company states that even if the Attorney General's proposal was somehow workable, Berkshire would be seeking bids on its own in 2003, a circumstance that substantially decreases its prospects for a successful outcome (id.).

2. Analysis and Findings

The Department's review of Berkshire's proposal indicates that the Optimization Agreement is consistent with the Company's resource portfolio objectives. Under the proposed Optimization Agreement, BP will provide consulting services regarding upstream interstate gas supply, transportation, and underground storage (Exh. BG-7, at 3-4). The commodity and capacity contracts that the Department previously approved will be maintained. Moreover, the pricing provisions under the contracts are the same as those previously approved by the Department. Thus, the Department finds that the Optimization Agreement is likely to benefit Berkshire's customers in the form of lower gas supply costs. Therefore, the Department finds that the Optimization Agreement, which merely provides for day-to-day consulting responsibility by BP, is consistent with the Company's resource portfolio objectives.

The evidence presented indicates that, by its very terms, the Optimization Agreement ensures that the Company will pay no more for natural gas under this Agreement than Berkshire would have in the absence of the Optimization Agreement (Exh. BG-2 Art. XII). Moreover, the evidence indicates that the Company has an opportunity to achieve additional gas-related savings by utilizing BP's expertise and aggregating purchases through the use of the members of the Alliance (Exh. BG-7, at 9). We note that the Optimization Agreement is structured so that BP has a strong incentive to provide the expected gas savings (Exh. BG-1). In fact, contrary to the Attorney General's concern that Berkshire might not achieve any designated savings, the record indicates that the Agreements entered into between BP and Berkshire in the instant case provide the potential for additional savings, which, in turn, would benefit the Company's customers (Exh. BG-7, at 10).[13] Accordingly, the Department finds that

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[13] The Department's objective is not to dictate a precise plan for resource or capacity acquisition but, rather, to ensure that the manner in which a company proposes to acquire resources and capacity is consistent with the public interest. By demonstrating that the Company's ratepayers will likely benefit from the Alliance arrangement even under the most unfavorable optimization conditions, we find that the Alliance arrangement contributes to an overall least cost resource plan and, thus, is consistent with the public interest.

the Optimization Agreement is consistent with the public interest, and we approve the Company's proposal.

With regard to the Allocation Agreement, the Attorney General argues that the Optimization Agreement, working in conjunction with the Allocation Agreement, lacks reasonable safeguards to assure an equitable allocation of the costs and benefits from the joint undertaking, particularly in light of incentives. The Attorney General further argues that the Company failed to submit any "specific allocation formulae" for review in this proceeding.

The Department, however, disagrees with the Attorney General and notes that the Allocation Agreement is sufficiently clear on how savings will be allocated among the companies, and among the companies and BP (see Exh. BG-1, at 23-31; Exh. BG-1, exh. B-2, at 1-6; Exh. BG-1, exh. B-10, at 2). The Department notes that the allocation guidelines state that each company's share of savings will be calculated on a "transaction by transaction basis," taking into consideration which company's assets were used to generate the savings (Tr. 2, at 222-223). The record indicates that where it is not practicable to allocate savings on a "transaction by transaction basis," the matter would be referred to the members of the Alliance to allocate such savings based on the agreed upon allocation criteria (see Exh. BG-1, at 2-3; Exh. BG-1, exh. B-10, at 2). If a question still remains, the matter would be referred "to the Senior Vice President, Transmission and Supply, of Energy East Management Corporation for resolution, which resolution may be an allocation in accordance with a Company's Participating Share as set forth in the Optimization Agreement, absent any other reasonable or equitable basis for making an allocation" (id.). The Department, therefore, concludes that Berkshire's savings calculation and allocation methodology are both reviewable and reasonable.

Accordingly, the Department finds the Company's Allocation Agreement to be reasonable.

The Attorney General expresses concern regarding the credibility, scope, validity, and reliability of the internal audit report on the 2001 Agreement. The Attorney General suggests that the Company conduct an independent external audit, rather than an internal audit, to review the implementation of the instant Agreement. The Department notes that the record shows that the audit of the 2001 Agreement was performed by qualified personnel of the members of the Alliance whose training and expertise were in internal auditing (see Tr. 2, at 176-190; 269-270). Further, the Company has indicated that the internal audit report will be reviewed by external auditors (Tr. 2, at 193). Therefore, we are not going to require an additional external audit at this time, but we require the Company to submit to the Department a copy of the evaluation that will be done by its external auditors.

Nevertheless, we note that the record with respect to the audit review of the implementation of the 2001 Agreement between the Company and BP indicates the need for the Company and BP to continue to work closely together to streamline and improve upon how daily transactions are tracked to ensure that savings generated using Berkshire's assets are properly credited to the Company (see Exh. D.T.E. 1-8; RR-AG-6; Tr. 1, at 63-152). The Department supports the recommendation of the audit report and directs the Company to continue to work closely with BP to refine the allocation methodology as appropriate. The Department further directs the Company to keep detailed documentation of all BP transactions under this Agreement and to submit to the Department annual reports detailing any refinements to the allocation methodology as suggested in the audit report, including the savings dollars accruing to the Company and how the savings were generated and allocated between the

LDCs, and a summary of the BP transactions on behalf of the Company. In addition, the annual report should highlight any problems that arise during the implementation of the Agreement and how the Company and BP have dealt with them to ensure a smooth implementation of the Agreement. The Company has 60 days from the end of every year to submit the report to the Department.

C. Purchase Agreement

1. Positions of the Parties

a. Attorney General

The Attorney General takes no position on the Purchase Agreement as a least-cost, reliable, and flexible resource.

b. Berkshire

The Company asserts that Berkshire and its customers will benefit from the Purchase Agreement and that the Purchase Agreement provides Berkshire with a reliable and flexible resource. The Company states that this Purchase Agreement is superior to the Purchase Agreement approved in D.T.E. 01-41 because the Company enjoys greater flexibility in the pricing of the gulf-coast supplies (Exh. BG-1, § 2.7; Exh. BG-4, § 5.3). The Company also states that the Purchase Agreement enhances reliability given the resources of BP (Exh. BG-7, at p.4; Exh. DTE 1-32; Tr. 1, at 33). The Company concludes that the Purchase Agreement is consistent with the public interest because it is a least-cost, reliable, and flexible resource (Company Brief at 9-10).

2. Analysis and Findings

The record indicates that pursuant to the Purchase Agreement the Company will purchase gulf coast supplies pursuant to attractive, flexible terms that are comparable to gas supply contracts available to Berkshire (Tr. 1, at 60). The Purchase Agreement also reflects an enhancement from the 2001 Agreement whereby the Company would enjoy greater flexibility in the pricing of its gulf coast supplies (Exh. BG-1, §2.7; Exh. BG-4, §5.3). Accordingly, the Department finds that the Purchase Agreement is consistent with Berkshire's portfolio objectives of implementing a least-cost supply strategy that maximizes flexibility and reliability and, therefore, is consistent with the public interest.

D. Margin Sharing

1. Introduction

After the close of the evidentiary hearing, the Company indicated that Berkshire intends to retain a portion of the margins generated from the Agreement (SRR-DTE-1). Margins are defined as the difference between the revenue generated from providing a certain type of service and the cost of providing this service. Margin sharing is the process by which the Department allows an LDC to retain a portion of such revenues (see Interruptible Transportation/Capacity Release D.P.U. 93-141-A, at 59 (1996) ("D.P.U. 93-141-A"). The Department allows LDCs to retain a portion of the margins from Interruptible Transportation, Interruptible Sales, Capacity Release and Off System Sales transactions (See D.P.U. 93-141-A, at 64).

2. Positions of the Parties

a. Attorney General

The Attorney General argues that the Department should not approve margin sharing in this proceeding (Attorney General Brief at 5). The Attorney General argues that there is no

Department precedent for a company to share in Alliance-type savings (id.). The Attorney General further argues that there is a difference in the type of margin sharing approved in D.T.E. 93-141-A and what the Company proposes in the current filing (id.). For instance, the Attorney General states that the Department in D.T.E. 93-141-A did not address margin sharing from optimization agreements but only addressed margin sharing generated from capacity release contracts (id.). Finally, the Attorney General argues that approving margin sharing under this contract would result in the Company's customers paying higher gas rates and being subject to more risk (id.).

b. Berkshire

The Company states that it expects to share margins generated from the Optimization Agreement with its customers (SRR-DTE-1). The Company contends that the Optimization Agreement is covered under the provisions of D.P.U. 93-141-A (1996) because the Optimization Agreement entails optimizing capacity management transactions (id.). The Company argues that capacity management tools, such as interruptible transportation, interruptible sales, capacity release and off-system sales, fit squarely within the established optimization categories (id.). The Company further asserts that these capacity management transactions allow Berkshire to take advantage of market opportunities and might enable the Company to generate margins that could reduce the cost of service for the firm customers (id.).

3. Analysis and Finding

The Company did not submit a proposal for margin sharing in its petition before the Department. In fact, the Department was unaware of the Company's intention to retain margins until the subject was presented in Berkshire's response to SRR-DTE-1.[14] More precisely, in its response to SRR-DTE-1,Berkshire stated that it understood the Department's precedent on margin sharing to apply to the margins resulting from the Optimization Agreement (id.). Prior to this response, nothing in Berkshire's filing or at the hearing made any of the parties aware of the Company's intention to engage in margin sharing. We find that this omission by Berkshire prevented the Department from adequately investigating this issue.

Even if the Company had properly presented margin sharing for the Department's consideration, Berkshire failed to meet its burden to support its margin sharing request. The Department stated that margin sharing represents a targeted incentive that is generally discouraged. D.P.U. 93-141-A at 62, citing Incentive Regulation, D.P.U. 94-158, at 20-21 (1995). The Department has required a company seeking approval of a targeted incentive program to identify the specific policy objective that the targeted incentive mechanism is intended to promote, to demonstrate why a broad-based proposal fails to meet those particular needs, and to show that an inconsistency between the targeted incentive and the overall goals of the broad-based proposal is minimized. D.P.U. 93-141-A at 62, citing D.P.U. 94-158, at 63.

In the proceeding at hand, the Company presented no evidence or testimony to support its margin sharing request in its initial filing or at the evidentiary hearings. Rather, Berkshire merely stated after the hearing had concluded that it believed margin sharing is appropriate for this type of arrangement (SRR-DTE-1, Supp.). The Company has the burden to identify what

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14 The Department issued a supplemental record request concerning margin sharing on July 10, 2002. The Company responded on July 15 and supplemented its response on July 23, 2002.

it is seeking approval for in its filing. Since the Company failed to do so, the Department cannot approve margin sharing in this filing. Accordingly, we direct Berkshire to suspend any margin recovery transpiring under the Optimization Agreement and its predecessor agreement. However, we will allow Berkshire to file a separate petition to request recovery of margins associated with this Agreement.

E. Attorney General's Motion to Compel

The Attorney General argued at the hearing that the Company failed to respond fully to one of its information requests because the Company did not provide the "preliminary" audit report that was requested in AG 2-9 (Tr. 2, at 383). The Attorney General made a Motion to Compel after the auditor testified that "preliminary drafts" of the audit were not retained (id.). The Attorney General also argued that the audit was not really "final" because certain months in the audit period required an additional review (id. at 384). The Attorney General requested that the Department compel the Company to provide the "preliminary report that was allegedly shredded" and sanction the Company for its failure to provide the "preliminary" audit (id.). The Attorney General also requested that the Department direct the Company to provide the "final" audit report, when available (id.).

We deny the Attorney General's requests. As the Company explained, it provided the "final audit" report to the Attorney General and explained that the documents that were not provided in response to the information request consisted of rough drafts that had not yet been reviewed to ensure accuracy and confirm that the facts were correct (id., at 191). These are not the type of "preliminary" documents that ordinarily need be produced in response to an information request. The circulation of unverified or incorrect information would benefit no one. Moreover, we cannot compel the production of documents that do not exist.

In addition, the preliminary report would be considered a non-scheduled record under the Department's record retention regulations (220 C.M.R. § 75.05(8)(b)). As a non-scheduled record, the Company had the option not to keep the preliminary report because the final report and the follow-up audit report are used for substantially similar purposes as the preliminary report (220 C.M.R. § 75.03(1)(b)). Thus, Berkshire's action in not retaining the draft document was consistent with the Department's record retention regulations. Moreover, the final documents provided responsive information.

Concerning the Attorney General's argument about whether the audit was final, we find that an audit can be consider final even though follow-up recommendations remained to be addressed. Additionally, we note that the Company provided the follow-up audit report to all parties on August 9, 2002, after the additional analysis was performed (RR-AG-6). We therefore deny the Attorney General's motions. No sanction is warranted in these circumstances.

V. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That the Gas Portfolio Optimization Agreement and Purchase Agreement between Berkshire Gas Company and BP Energy Company are hereby approved; and it is

FURTHER ORDERED: That Berkshire Gas Company comply with the directives as contained herein.

By Order of the Department,

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Paul B. Vasington, Chairman

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

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Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).